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The Future of China: Three Scenarios

by Murray Weidenbaum

As we begin to think about the 21st century, we are entering a time of fundamental global change. The most dramatic shift will be the movement of China to the status of great power. Yet, the only specific forecast for the future of China that we can make with confidence is that a straight-line extrapolation is most unlikely to occur. China will not continue to grow at double digit rates for the coming decade. Nor is the rest of Southeast Asia going to grow at the 8 percent that has been registered for the past decade and more. Nor is everything going to go smoothly.

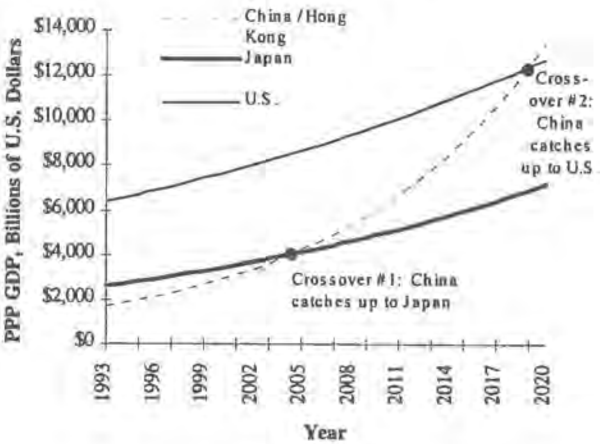
The uncertainties facing China and Southeast Asia generally are profound and numerous. What follows the death of Deng Xiaoping? Will the Hong Kong integration go well? Will Beijing and Taipei develop a *modus vivendi*, rather than continue to move from crisis to crisis? Will Indonesia experience political and economic turbulences after Suharto passes from the scene? What about energy shortages, environmental problems, corruption, piracy, et al.? Surely, there is no shortage of questions and policy problems to be faced.

In a sense, we all have learned humility from the collapse of the Soviet Union. Every China expert now begins the forecast with a caveat: None of us really knows what will happen after Deng goes (assuming he hasn't already). The sensible approach is to develop several scenarios and examine their implications.

Murray Weidenbaum is chairman of the Center for the Study of American Business and Mallinckrodt Distinguished University Professor at Washington University in St. Louis. This article draws heavily from Murray Weidenbaum and Samuel Hughes, *The Bamboo Network* (New York: Free Press, 1996).

Figure 1

Growth Scenario Showing China Catching Up



Note: Because of considerable difficulty in estimating China's GDP, the World Bank's purchasing power parity (PPP) is averaged with conventional GDP based upon international exchange rates to forecast China's growth scenario.

Source: Murray Weidenbaum and Samuel Hughes, *The Bamboo Network* (New York: The Free Press, 1996), p. 226.

Scenario #1: Successful Transition to a Market Economy

This is the trouble-free scenario, at least compared to the others. In scenario #1, China completes the transition to a market-based, privately run economy. Within the coming decade, it overtakes Japan as the largest economy of Asia (see Figure 1). This assumes, of course, that, after Deng's death, economic reformers maintain policy control. Also, Hong Kong is successfully incorporated into the People's Republic of China and closer economic and cultural ties are developed with Taiwan. Quietly, Chinese and Taiwanese companies are already joining forces to explore for oil in the South China Sea. A Taiwan-based firm is investing in the project through its Panamanian subsidiary to skirt the Taipei ban on direct investment in China. In scenario #1, Western investment replaces the overseas Chinese family enterprises (the bamboo network) as the major source of capital for China's continued economic expansion.

As was the case in Korea and Taiwan, greater wealth and prosperity lead to political reform. In essence, China will be following the Asian model of development. In the West, priority is given to personal freedom and political liberties. The Asian development process works the other way. The expansion of economic freedom initially occurs at a time of continued political repression. Yet, the rise of a middle class and of private enterprise disperses power in the society. As a result, pressures arise for greater political freedom. Witness Taiwan recently held its first free presidential election.

Some serious complications are dealt with successfully by the Chinese authorities. Economic growth continues, but at a more sustainable 8 percent. However, inflationary pressures heat up. Nevertheless, the central bank learns to deal with these matters and is granted the power to take decisive action.

The strong military establishment cooperates with the civilian authorities in this scenario. The People's Liberation Army (PLA) shares in the general prosperity through its substantial business holdings.

Inefficient state-owned firms are reorganized. Their deficits no longer sop up domestic investment capital. The government in its dealings with these perennial deficit operations takes a sink or swim attitude. As a result, some sink, but some swim also. A modern legal system is gradually constructed, an important step in attracting large amounts of investment capital from the West. Property rights, accounting conventions, and commercial banking are established. Some complications are going to be very difficult to deal with, even in the most optimistic circumstances. Energy shortages will grow with economic expansion.

All of the responses involve serious side effects. One solution is to exploit potentials of the South China Sea. However, such action would stir up problems with Malaysia, Philippines, Vietnam, and Taiwan because China claims areas now held by or also claimed by one or more of those smaller Southeast Asian nations. The possibility of military confrontation with the United States would arise. Alternatively, the Tarim Basin reserves in the far western part of China could be developed more intensively. This approach would require building all sorts of expensive supporting infrastructure. Quickly developing the Tarim petroleum reserves also requires giving western oil companies a much larger role, especially in awarding them more attractive sites now reserved for future exploration supposedly by domestic firms which somehow will acquire the requisite technology.

If China can succeed, it will give the United States a run for its money for being the largest economy in the middle of the 21st century.

The Chinese show a marked reluctance to share wealth, unlike the Arab governments which welcome British and American exploration companies. China's lingering fears of imperialism are very strong, which is understandable given the country's history of foreign exploitation and occupation, especially by Great Britain and Japan.

Infrastructure shortcomings will worsen as the economy expands rapidly. There is limited incentive for large-scale public investment. Meanwhile, the growth of air travel and widespread use of cellular phones partially fill the gap. Simultaneously, environmental pollution will accelerate with the rising output of a growing economy. The "cleaner" coal reserves soon will be used up, and thus more

coal usage will be a dangerous response to the lack of an adequate petroleum supply.

In the long run, China's continued rapid economic expansion may be limited by environmental and resource constraints. China is already the world's third largest emitter of greenhouse gases. Generating an adequate energy supply will require tradeoffs with economic, social, and political objectives. Dealing with all these issues will be a very tall order. If China can succeed, it will give the United States a run for its money for being the largest economy in the middle of the 21st century (see Figure 1). However, other scenarios need to be considered.

Scenario #2: Reversion to Communism

If Scenario #1 requires everything to go right, Scenario #2 means everything goes wrong. In essence, China remains a communist nation and the hard liners take control after Deng. They quickly limit or reverse economic reforms. *Mang lui* (the dispossessed peasants) support reversion to communism which represents an abrupt shift from the initial strong support of farmers for Deng's economic liberalization. The existing special economic zones would remain, but their rights and privileges would be restricted. No new zones would be created. The special privileges now accorded to foreign investment (which have been cut back in the past year) would be ended.

The rich and vibrant economy of Hong Kong would be squeezed for two reasons. First, Shanghai — whose government is dominated by national government loyalists — would seize the opportunity to regain its supremacy among the cities of China. Second, the power structure in Beijing would try to take over at least a portion of Hong Kong's great wealth. Greed surely is still a motivating factor.

Under the second scenario, the power of the military increases, especially given the almost universal desire to maintain order (to avoid *luan*, chaos). A stronger military is likely to result in more saber-rattling in the South China Sea as well as serious threats to Taiwan. Surely, the American desire for a peaceful settlement of the relationship between the mainland and Taiwan is a highly desirable objective. However, the touchiness of the People's Republic of China on this issue is understandable when viewed in a historical context. When I expressed this view at a meeting with Chinese government officials, they responded with a pointed question; did not the United States use military force when the South attempted to secede in the 1860s?

If the second scenario becomes a reality, China's economy likely will nose-dive. Much of the bamboo network investment would move to Southeast Asia, Australia, and the West. New Western investment would virtually cease except for the funds that would be necessary to protect existing investments.

In this eventuality, India pushes to replace China as Asia's leading growth area. That huge nation would bring special assets to the competition: widespread use of the English language and establishment of a modern legal system (patterned after the British). However, India is also hobbled by a cumbersome bureaucracy which is a major inhibitor to investment, entrepreneurship, and innovation.

At the same time, Singapore, Malaysia, and Indonesia would try to develop a new "growth triangle" modeled after the successful "growth triangle" of Taiwan, Hong Kong, and coastal China. Despite the political differences, the economic unification of that area has been very successful. A substantial amount of cross trade and cross investment occurs. All in all, the second scenario describes a very unstable situation. Likely, it would lead to a very different scenario.

Scenario #3: Instability and Fragmentation

China's situation could go from bad to worse. In the broad sweep of that nation's history, China has not always been united. What we would call the "outer empire" (which excludes the Han or ethnic Chinese) could separate and fragment. Possible candidates for splitting up include the Moslem areas of Mongolia and Xinjiang (the latter containing the vital oil reserves in the Tarim Basin), the Buddhist area of Tibet, and the Japanese-oriented area of Manchuria. If such an extreme eventuality would occur, it would leave the Han Chinese in control of industrialized Southern and Eastern regions — notably Beijing, Shanghai, and Guangdong — as well as much of agricultural central China. China would become a major source of political and military instability in Asia, but no longer a major economic competitor. One scary prospect is the possibility of refugees by the millions fleeing to adjacent countries.

What Is Likely to Occur?

It is not likely that any of the three scenarios will occur as spelled out here. A "Chinese menu" could occur (some from column A and some from column B), avoiding an extreme outcome. The result could be a shifting combination of economic openness, socialist ideology, and local independence.

As described by one analyst, the following relationship would develop: "Beijing will pretend to rule the provinces, and the provinces will pretend to be ruled by Beijing." In any event, neither policy nor practice will move in a straight line — nor to a polar alternative.

A parallel to the United States comes to mind. The competition between Jefferson and Hamilton — especially between centralized control and decentralized operations — endures to this day. From time to time, we go to bigger government, then to smaller government, and then reverse field again. Similarly, shifts occur in federalism, with states gaining ascendancy at times, later local governments assuming more responsibility, and often followed by the role of the federal government rising rapidly.

The United States is a mixed economy, with substantial government intervention in the economy, but in a very uneven manner. Consider the different positions of the defense industry, the automotive industry, and the chemical industry. In the defense industry, the government carefully determines the product to be sold and the way it is manufactured. In the auto industry, the government strongly influences the nature of the final product, but not the production or marketing process. In the chemical industry, government strongly influences manufacturing and distribution, and only occasionally the specific nature of the product. Why would we expect China to be very different?

The Outlook

In any eventuality, China is becoming a great power with all sorts of foibles and shortcomings. We have to learn to accept that, as we do in the case of other superpowers. It is dangerous for our foreign policy to be driven by narrow domestic forces. Some of the issues they raise are quite self-serving, when carefully examined. Yes, the Chinese use prison labor. But so do we. In our case, it is called the Federal Prisons Industry, a bureau in the U.S. Department of Justice.

Yes, Asian companies pay much lower wages than American workers receive. But like us, they pay the wage prevailing in the region where the workers perform. Those that advocate U.S. firms paying U.S. wage rates in Asia are economically illiterate or playing games — the old protectionist game. On reflection, there is nothing sinful or even surprising when employers pay market wages, rather than viewing their role as an eleemosynary institution.

The use of child labor is a more difficult issue. It helps to remember that, at the comparable stage of development, we used child labor. In the case of poor Asian countries today, sadly, brothels (not idyllic homes) are often the alternative to low wage factories. But as our economy developed, we shifted away from the widespread use of child labor. It is useful to recall that we did not change because of foreign pressure.

On the positive side, the United States has no basic conflicts with China. There surely is no territorial dispute, the traditional basis for war. More fundamentally, there is little negative history between the two nations. This is quite unlike the Japanese (the memories of the World War II occupation are still vivid among the older generation) and the British. In the latter case, the two opium wars a century ago may be dim in the memories of Westerners. But the Chinese clearly recall that period of blatant imperialism where the English used their military might to force the Chinese to buy opium from British India.

China is the most exciting business opportunity in the global economy.

In contrast, there are many potential complementarities between the two nations. China possesses a great labor supply and potential markets, while the United States has technology, marketing capability, and organizational know-how. Several American business successes in China are quite stunning. For example, Procter & Gamble is the largest daily-use consumer-products company, domestic or foreign, operating in China. P & G's Rejoice shampoo generates sales in Guangdong province only second to the level attained in the United States.

Lee Kuan Yew of Singapore (the distinguished senior minister) said it well, albeit melodramatically: "The size of China's displacement of the world balance is such that the world must find a new balance . . . This is the biggest player in the history of man." The realignment of world power relationships, in retrospect, may be akin to the experience of the United States in breaking into the mid-19th century club of advanced industrialized nations, then monopolized by Europe.

China is the most exciting business opportunity in the global economy. In late 1994, the Gallup Organization surveyed a sample of Chinese consumers across that vast nation. Keeping in mind the shortcomings of statistical extrapolation, Gallup reported that 95 percent have some electricity at home, 92 percent watch television, and 70 percent read a newspaper. However, only 3 percent own an automobile, 4 percent have running water, 9 percent own a telephone, and 24 percent have cable TV. In terms of brand penetration, 62 percent have heard of Coca-Cola, 22 percent Ford, 15 percent KFC, and 14 percent Nike.

No other region contains China's potent combination of physical and human resources. In my view, it is vital for Americans to better understand events in that exotic part of the world and not be on the outside trying to look in.

Listening to the experiences of Americans and other foreigners who do business in China, hard knocks are to be expected.

Words of caution are always in order. Not all is sweetness and light in that relationship. Americans doing business in China report serious negatives, especially tales of corruption, both personal and official. More than 300,000 local government officials in the poor province of Anhui were recently caught siphoning or misusing public funds. Most were disciplined, but few were prosecuted.

Foreign businesses are often confused as to who has the ultimate authority to negotiate deals in China. Often there are many approvals or "chops" involved. Some Western firms use Chinese intermediaries, either from the mainland or among the ethnic Chinese entrepreneurs in Southeast Asia, to help with the intricacies and special cultural nuances involved. Personnel connections or *guanzi* can help in cutting through the many layers of bureaucracy.

Many U.S. companies join forces with overseas Chinese businesses in attempting to penetrate the China market. These "bamboo network" firms can

serve as a valuable link between East and West, especially in opening doors to newcomers to East Asian ways of doing business.

AT&T and Lockheed from time to time have joined forces with the companies of Li Ka-shing of Hong Kong. Amoco Oil and Radisson Hotels partnered with the Salim Group of Indonesia. The insurance brokerage Alexander & Alexander entered into extended arrangements with the Lippo Group of Malaysia. KFC and 7-11 have joint ventures with the Charoen Pokphand Group (or CP) of Thailand.

The head of the CP Group laments that U.S. lawyers can destroy the chemistry needed between partners to make a deal work, that the legalism so endemic in the United States often clashes with the Asian emphasis on personal relations. In any event, Wal-Mart tried to work with CP to enter China but wound up teaming up with enterprises in mainland China. On a more positive note, in 1995 Monsanto formed a joint 60-40 percent venture with the Jiangsu Chemical Pesticide Group on the mainland to make and market its Therminol heat-transfer fluids.

Listening to the experiences of Americans and other foreigners who do business in China, hard knocks are to be expected. Even some of the experienced Hong Kong investors got burned in 1989 when they opened a restaurant for tourists near Tiananmen Square, just a week before the shooting. No amount of *guanzi* or due diligence would have prevented that fiasco. In a variation on that theme, Gordon Y. S. Wu, the prosperous Hong Kong developer, stated on one occasion that there were more sharks on the land (in Hong Kong) than in Victoria Harbor.

China is the prime example of my standard forecast; in change, there is both threat and opportunity. In *feng shui* (Chinese numerology), eight is a lucky number. So, I leave you with my favorite eight letters for dealing with China: Good luck!